

REPORT OF THE AUDITOR-GENERAL TO COUNCIL ON THE FINANCIAL STATEMENTS OF MORETELE LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

1. AUDIT ASSIGNMENT

The financial statements as set out on pages 3 to 20, for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 126 of the Municipal Finance Management Act (MFMA). These financial statements are the responsibility of the municipal manager. My responsibility is to express an opinion on these financial statements, based on the audit.

2. SCOPE

The audit was conducted in accordance with the International Standards on Auditing. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements
- assessing the accounting principles used and significant estimates made by management
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations which came to my attention and are applicable to financial matters.

I believe that the audit provides a reasonable basis for my opinion.

3. BASIS OF ACCOUNTING

The municipality's policy is to prepare financial statements on the entity specific basis of accounting, as described in paragraph 1 of the accounting policies to the financial statements.

QUALIFICATION

3.1 Cash and bank

Bank reconciliations were only prepared for the main bank account and not for the bank accounts relating to the infrastructure projects.

I have not received all the information and explanations that I considered necessary to establish the completeness, accuracy and valuation of the unreconciled bank accounts amounting to R 3.5 million.

3.2 Change in accounting policy

Standards of Generally Recognised Accounting Practice (GRAP) 3 stipulates that when initial application of a Standard of GRAP has an effect on the current period or any other period and the amount can be determined, it should be disclosed as required in paragraph 28. In the current financial year the municipality decided to implement its conversion to GRAP/GAMAP and this has resulted in significant changes to the accounting policies with regard to fixed assets and reserves.

A review of the financial statements indicated that the municipality did not comply with:

- disclosure requirements in terms of paragraph 28 of GRAP 3 and
- the change in accounting policy was not applied retrospectively and the reasons for this decision had not been disclosed in the financial statements.

Note 31 to the financial statements change in accounting policy – levy income recognition should have reflected a split between repairs and maintenance to municipal offices and carrying amount of vehicles donated by the Bojanala Platinum District Municipality. Where an entry was recorded as a result of an incorrect application of the accounting statement, the correction should be classified in the financial statements as a correction of an error and disclosed accordingly.

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA.

3.3 Debtors

- A debtor to the amount of R0.2 million is no longer recoverable at year-end.
- Bad debts amounting to R3.2 million was incorrectly written off against the Accumulated Surplus balance in the Statement of Changes in Net Assets. This amount was also included in the creditors figure in the balance sheet. Furthermore, no authorisation existed for the write-off nor was there

adequate supporting documentation for the write-off. The provision for bad debt amounting to R3.2 million in the notes to the financial statements was erroneously reflected as provision for insurance.

I have not received all the information and explanations that I considered necessary to establish the completeness, accuracy and valuation of the outstanding debtors' balances at year-end amounting to R 23.9 million.

3.4 Leave pay provision

- A fixed monthly amount was raised for leave pay provision in the general ledger. There is no indication or calculation on how this monthly amount was determined.
- The municipality does not have a system to manage employees' leave balances accurately.
- There was no supporting evidence for final leave payments amounting to R0.1 million made during the current period.

I have not received all the information and explanations that I considered necessary to establish as to the completeness, accuracy and valuation of the liability raised as a provision for leave pay of R1.4 million as disclosed in the financial statements.

3.5 Other current liabilities

Provisions included in the financial statements were not recognised in terms of the criteria stipulated by GAMAP 19 paragraph 19, 95 and 96. Provisions have been incorrectly classified under creditors, as a result creditors are overstated and provisions understated by R1.6 million.

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA

3.6 Revenue

- The suspense account relating to revenue with a balance of R0.7 million was not cleared at year-end. This amount was reflected under creditors and as a result the creditors' amount in the financial statements has been overstated.
- The following notes relating to revenue did not reflect prior year amounts
 - Property rates
 - Service charges
 - Government Grants and Subsidies.

The note for Property Rates indicated that income was received from residential properties. However, to date only commercial properties in the district were invoiced for property rates.

GAMAP 9 paragraph 63 states that the financial statements should also disclose unfulfilled conditions and restrictions attached to transfers and government grants, however, these notes are incomplete as no amounts are included and descriptions are not properly completed.

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA

Revenue reconciliations are not prepared and reviewed on a weekly basis as required by Section 62(2) (h) of the MFMA.

3.7 Fixed assets

- The municipality does not have a fixed asset register as required by section 96 of the MFMA.
- Fixed assets are also not tagged and physical verification of assets could not be performed.
- Fixed assets were not revalued as required by GAMAP 17.
- The municipality has not assigned a responsible person to timeously carry out asset counts and physical verification on the condition of assets.
- In addition all office furniture at the municipality is not insured.

I could therefore not establish as to the existence, completeness, rights and obligations and valuation of fixed assets amounting to R198 million.

3.8 Non-compliance with the disclosure requirements of GAMAP/GRAP

- The reporting date is incorrectly stated as 30 June 2005 in the Statement of Financial Position, Statement of Changes in Net Assets and Cash Flow Statement.
- Appendix F: The disclosure of grants and subsidies in terms of the MFMA was omitted from the financial statements.
- The Cash Flow Statement does not contain comparatives. The current year figures are incomplete.
- An amount of R 8.5 million in the Statement of Changes in Net Assets reflected against Transfer to Capital Replacement Reserve in the accumulated surplus column should have been reflected against Property, Plant and Equipment purchased.

- The transfer to the Capital Replacement Reserve (R18.1 million) and Property Plant and Equipment purchased (R8.5 million) rows in the statement of changes in net assets are incorrectly reflected.
- A number of amounts reflected in the financial statements did not correspond with the corresponding note:

| Item | Financial statement amount | Amount in note to the financial statements | Difference |
|--|----------------------------|--|-----------------|
| Creditors | R 35.8 million | R 25.1 million | R 10.7 million |
| Other debtors | R 23.8 million | 0 | R 23.8 million |
| General expenses (2005) | R 24.3 million | 0 | R 24.3 million |
| Cash generated from operations | R 146.2 million | R 80.6 million | R 65.6 million |
| Replacement reserve/ government grant reserve | R 2.5 million | R 13.9 million | (R11.4 million) |
| Cash and Cash equivalents | 0 | R 3.4 million | R 3.4 million |
| Unspent conditional grants and receipts(2005) | R 4.5 million | R 3.4 million | R 1.1 million |

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA

3.9 Incorrect disclosure of expenditure

Section 125(1)(c) of the MFMA requires the total amounts paid in audit fees, taxes, levies, duties, pension and medical aid contributions to be disclosed in a note to the financial statements. On review of the financial statements the following expenses paid during the period were not separately disclosed:

| | |
|-------------------------|--------------|
| - Audit fees | R0.2 million |
| - Pension contributions | R0.7 million |
| - Medical contributions | R0.9 million |

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA

3.10 No explanations for variances disclosed

In terms of the GAMAP/GRAP basis of financial preparation the municipality has to disclose the following information in an appendix to the financial statements:

- variances and explanations for variances in balances between current and prior year amounts
- variances and explanations between current year and budget amounts.

Appendix E(1) to the financial statements only reflected variances in amounts, no explanations for the variances were provided.

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA.

3.11 Incorrect amounts - prior year figures

The comparative amounts in the current year's financial statements for general expenses and government grants and subsidies received are both overstated by R10.3 million when compared to the prior year's financial statements.

I have not received all the information and explanations that I considered necessary to establish the completeness, accuracy and validity of changes in the previous year's amounts for general expenses and government grants received.

Management lacked the ability to put in place controls to help it identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities, as required by the MFMA.

3.12 Value-added Tax (VAT)

- The municipality is registered on the invoice basis. However, the municipality has been claiming and paying VAT on the receipt basis.
- A reconciliation of the VAT forms and the general ledger accounts for the year under review has not been prepared.
- The VAT201 forms had not been submitted to the South African Revenue Services since September 2005.
- On inspection of the Statement of Financial Position it was noted that the prior year's VAT balance (R11.6 million) has been disclosed under non-current assets when it should have been allocated to current assets.

The financial statements reflected a VAT balance of R0.1 million under current liabilities and R2.7 million under current assets. I was not satisfied that these balances were correct.

3.13 Journals not authorised

No copies of journal entries were retained on file for journals captured on the system. There are no supporting documents for journals captured or evidence of any journals being authorised. Journals relating to the following components could not be verified:

- Employee costs R2.9 million
- Expenditure R0.6 million
- Revenue R1.0 million
- Creditors R0.3 million

3.14 Unauthorised expenditure

There was an overspending for the following expenses incurred for the period under review when compared to the budgeted amounts. The municipality has to obtain prior approval from provincial and local government for any expenses that will exceed the budgeted amounts for the year. The reasons for the expense item exceeding the budget must be stated. If prior approval for an expense exceeding budgeted amounts was not obtained, the amount exceeding the budgeted amount is regarded as an unauthorised expense.

| Expense | Actual | Budget | Difference |
|-----------------------------|---------------|---------------|-----------------|
| Remuneration of Councillors | R 4.4 million | R0.5 million | (R 3.9 million) |
| Repairs and maintenance | R 2.0 million | R 1.3 million | (R 0.7 million) |
| Contracted services | R 4.2 million | R 1.2 million | (R3.0 million) |
| Contributions to CRR | R 9.6 million | R8.8 million | (R0.8 million) |

3.15 Expenditure

- There were no supporting invoices for expense payments amounting to R1.9 million.
- The order form for expenditure amounting to R1.2 million did not agree to the invoice.
- Expenditure amounting to R 5.2 million was not authorised.

- There were no supporting invoices for expenditure pertaining to repairs and maintenance amounting to R 0.4 million.
- Amounts totalling R0.3 million were paid on invoices that were not in the name of the municipality.
- I was unable to obtain copies of contracts for all leased office equipment at the municipality.

I therefore could not establish the occurrence, validity and authorisation of the above expenses.

3.16 Funds and reserves

A variance of R3.1 million was noted in respect of the Accumulated Surplus balance disclosed in the financial statements when compared to the general ledger.

3.17 The Division of Revenue Act, 2005 (Act no 1 of 2005) (DORA) payment schedule differs from the bank statements.

A total difference of R1.0 million was identified as reconciling differences between schedule 3 of the DORA payment schedule and the bank statements for the year under review.

Most of the above reporting related matters is due to the Councils inability to create the right environment for good internal control and financial management. Council's inability to implement structured training programs to address some of the skills gap had a negative effect on the control environment, which made the implementation and monitoring of the control a very difficult and ineffective process.

4. ADVERSE AUDIT OPINION

In my opinion, because of the significance of the matters described in the preceding paragraph and its effect on the financial statements, the financial statements have not been prepared, in all material respects, in accordance with the basis of accounting described in paragraph 1 of the accounting policies to the financial statements and in the manner required by the Accounting Standards Board.

5. EMPHASIS OF MATTER

Without further qualifying the audit opinion, attention is drawn to the following matters:

5.1 Annual financial statements not received on time

Circular 36 from National Treasury requires that the annual financial statements together with the supporting working papers be handed over to the Auditor-General and National Treasury within two months after the financial year end. The financial statements and supporting information for the municipality was supposed to have been handed to the auditors by 31 August 2006. However, the financial statements were only received the auditors on 4 September 2006 and the supporting information on 11 September 2006.

5.2 Control over creditors

The municipality did not maintain a creditors' sub-ledger for the management and payment of its creditors. Furthermore, the municipality did not perform reconciliations between suppliers' statements and its general ledger.

5.3 Internal Audit Section

The municipality did not have an internal audit section as required by section 165 of the MFMA.

5.4 Fraud Prevention Plan

The municipality does not have a fraud prevention plan in place as per Section 62 (c) of the MFMA.

5.5 Overtime overpaid

In terms of SALGA regulations monthly overtime paid cannot exceed 30 per cent of the employees' monthly basic salary. The municipality does not have any checks in place to monitor the above regulation. As a result there were many instances during the current period where overtime paid exceeded 30 per cent of the employees' monthly basic salary.

5.6 Non-compliance – unspent conditional grants

Grants used to fund operational and capital expenditure have not been treated in accordance with GRAP. A separate bank account does not exist for all the unspent conditional grants.

5.7 Non-compliance with section 18(1) – (2) of the Water Services Act, 1997 (Act no 107 of 1997).

The municipality failed to comply with section 18(1) & (2) of the Water Services Act that requires the municipality within four months of the end of the

financial year to submits a report to the Minister of Water Affairs and Forestry, the Minister for Provincial Affairs and Constitutional Development, the Province, and every organisation representing municipalities having jurisdiction in the area of the water services authority on the implementation of its development plan.

5.8 No backup and user policies

No formally documented and approved backup policy was available and no procedures exist to address the following user account management issues:

- The timeous removal of employees' logon scripts upon termination of service, promotions or transfers.
- Steps taken to identify and remove inactive accounts.
- A periodic review to ensure that employees' current level of access is commensurate with their job descriptions.
- Resetting of password procedures.
- Granting of command line access (root access).

5.9 Late submission of audit report

In terms of section 126(3)(b) of the MFMA I am required to submit my report to the accounting officer within three months of the receipt of the financial statements. In the interest of improving accountability and due to the process implemented by me to ensure consistency in the manner in which material audit findings are reported I have delayed the finalisation of my reports to no later than 08 December 2006 where the financial statement in question were received by 31 August 2006.

6. APPRECIATION

The assistance rendered by the staff of Moretele Local Municipality during the audit is sincerely appreciated.



LD Zondo *for* Auditor-General

Rustenburg

08/12/ 2006



A U D I T O R - G E N E R A L